

## **Escape Refund Delays in 2003**

The Illinois Department of Revenue (IDOR) anticipates that a shortage of money in the Refund Fund will again delay income tax refunds in 2003. Tax professionals who want to be sure that their clients get refunds as quickly as possible are urged to file those returns electronically.

Tax professionals are urged to file their clients returns electronically

season when it must begin to repay the \$150 million borrowed in August to eliminate the 2002 refund backloa.

Adding to the problem will be budget cuts that are likely to slow the processing of paper tax returns. Electronically filed returns will be processed before the delays begin,

meaning those taxpayers will get their refunds on time. 🐲

The department anticipates that it will run short of Refund Fund money before the end of the filing

## IRS Selects Issues for IIR Program

he Internal Revenue Service (IRS) and the Treasury Department recently announced the selection of issues for the 2002 Industry Issue Resolution (IIR) Program.

The IIR program provides guidance on frequently disputed or burdensome tax issues. Benefits of the program include reduced costs and burden, and eliminating uncertainty regarding proper tax treatment, for both taxpayers and IRS. The program was successfully piloted in 2001 and made permanent this year.

"The response to the IIR program has been excellent. We thank the business community for the issues they have identified and look forward to their increased participation in the program in the future," said IRS Commissioner Charles O. Rossotti.

The issues selected for the IIR program this year came from 38 issues submitted to IRS from businesses, tax practitioners, and associations. Issues were selected

based on the criteria set forth in Notice 2002-20. This year's selected issues include

- depreciation of cable television systems under Section 168,
- tax treatment of pre-production costs of creative property,
- inventory valuation method for cores in the auto remanufacturers business,
- recovery period for depreciation of gasoline pump canopies,
- substantiation of the amount of expenses for meals furnished by child care providers,
- definition of highway tractors subject to the heavy truck tax under section 4051, and
- deduction and capitalization of costs incurred by utilities for assets used for power generation.

(IIR Program continued on Page 20)



### **Director Bower's Message**

Glen L. Bower
Illinois Department of Revenue Director

As we head into fall at the Illinois Department of Revenue, we are struggling with how to maintain our operations with a declining workforce. In July and August, 79 employees took advantage of the Early Retirement Incentive. By the end of the year we anticipate that the total will exceed 300, many of them our most experienced employees.

The restrictions on filling positions (we can only fill half the vacancies) mean changes in the way we do business. We will try to increase use of electronic commerce to maintain service levels with fewer employees by:

- increasing the numbers of electronically filed tax returns that can be handled more efficiently without mail opening, data entry, and paper handling costs;
- employing electronic methods of tax enforcement such as increased use of the federal refund offset program to efficiently collect delinquent debt; and

encouraging taxpayers to use automated electronic service options, such as the Internet refund inquiry system that 150,000 taxpayers used last year to check on the status of the income tax refunds, freeing our telephone representatives to answer questions from taxpayers.

This would be a good time to enroll in our electronic filing program for individual income tax returns. In April, we will have to use money in the Refund Fund to repay funds borrowed in August to liquidate the 2002 backlog of unpaid refunds. Barring an unforeseen change, the repayment will further delay refunds. Taxpayers whose returns are filed electronically can have them processed before the shortfall occurs.

The Department of Revenue will do its best to minimize the effect of budget cuts on taxpayers. There will be effects. In June we closed district offices in



## **Territory Manager Kopeck's Message**

Joanne Kopeck
IRS Territory Manager
Small Business/Self-Employed Division
Taxpayer Education and Communication, Area 4

One of our top priorities at the **Internal Revenue Service** (IRS) is, very simply put, to shut down abusive tax avoidance transactions. A recent policy change will help us with this effort.

Under the new policy, the IRS may request tax accrual workpapers when it audits returns that claim a tax benefit from certain tax avoidance transactions that the IRS has identified as abusive. In all other cases, the IRS will continue to apply its current policy of requesting tax accrual workpapers only when unusual circumstances warrant such a request. Tax accrual workpapers normally are prepared by taxpayers and their independent auditors to evaluate the taxpayer's financial condition.

"This limited expansion of when the IRS will request tax accrual workpapers is critical to our ongoing effort to curb abusive tax avoidance transactions and to ensure compliance with the tax laws," said IRS Commissioner Charles O.

Rossotti. "It is an important part of our mission of ensuring fairness to all taxpayers."

The new policy primarily affects returns filed on or after July 1, 2002. For those returns, whether the request for tax accrual workpapers will be routine or merely discretionary, or will be limited to the abusive transaction rather than all the workpapers, will depend on several factors, including whether the abusive transaction was disclosed. For returns filed before July 1, 2002, the IRS may request tax accrual workpapers if the taxpayer did not make the required disclosure of the abusive transactions.

Although the Supreme Court confirmed the IRS' right to summon tax accrual workpapers in 1984, the agency has not made it a standard examination technique. The IRS will continue its restraint in requesting tax accrual workpapers, but will regularly do so to combat abusive tax avoidance transactions.

Park City, Peoria, Urbana, and California, and our travel budgets and equipment purchases have been restricted. Our concentration in this period will be on collecting and depositing the tax receipts needed to pay for state services.

In this edition of the newsletter you will find a number of items that I believe will be of interest. There is a recap of the tax legislation that passed during the General Assembly's spring session. Tax professionals had requested that we provide this annual summary of new tax laws.

You will also find details on how the Department of Revenue will implement the decoupling from the bonus depreciation that was included in the Federal economic stimulus package passed in March. Public Act 92-603 requires taxpayers to add back the bonus depreciation for Illinois purposes.

If you have a comment or suggestion, feel free to contact me.



IRS Chief Counsel B. John Williams effectively summed up this new policy; "This new policy encourages taxpayers to avoid overly aggressive transactions. It brings a new vitality to our self-assessment system and changes the risk calculus to make investing in overly aggressive transactions a very costly proposition. It is another example of the IRS using existing tools for effective tax administration."

More information on the policy change appeared in Announcement 2002-63, which is available on the IRS Web site at www.irs.gov. It was also published in Internal Revenue Bulletin 2002-27, dated July 8, 2002.

Of course, Criminal Investigation's (CI) enforcement strategy to combat abusive trusts is to focus primarily on promoters and on clients who have willfully used the promotion to egregiously evade tax. Further, fraudulent trust issues are addressed through a national strategy that includes CI, the IRS Examination and Collection Divisions, IRS Chief Counsel's Office, and the Department of Justice. As part of this strategy, emphasis is placed on multi-function coordination, the identification of fraudulent offshore promotions, and the use of civil and criminal enforcement actions.

It is very difficult to determine precisely the amount of fraud attributable to these schemes because of their design and inherent complexity. However, it can be said that these schemes are directed towards taxpayers with high incomes, and the potential for lost tax revenue could be massive. Our commitment to uncovering abusive schemes remains unwavering. You can read more about tax scams later in this issue of the Fed-State Review.

Before we know it another filing season will be upon us. As always, I look forward to working with all of you in the days and months ahead.

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# IRS Puts New Refund Application Through Trial Run

The **Internal Revenue Service** (IRS) is testing a new Internet-based service that will allow taxpayers and practitioners to check the status of a refund anytime from anywhere. The Web application is expected to be fully operational for the 2003 tax-filing season.

The agency moved the pilot project to the front page of IRS.gov in order to test its ability to handle a large volume of users. Taxpayers who filed Form 1040, Form 1040A or Form 1040EZ and are due a refund may use the application. The program will mark the first time taxpayers have been able to access their accounts directly through the Internet.

Taxpayers can use the Internet service to find out if their tax return has been processed and when their refund will be mailed or directly deposited. Users must know their Social Security number, filing status (*i.e.* 

single, married filing joint) and the amount of refund on the return.

The application can help taxpayers learn if there is a problem with the refund and recommend steps to resolve it. Also, taxpayers can find out if their check was returned to the IRS as undeliverable.

The refund service has undergone extensive testing throughout its development, including a six-month, comprehensive security process to qualify for an IRS security certification. A security certification is required for any IRS computer system that deals with taxpayer information.

Taxpayers can access the new IRS Web site application 24-hours a day, 7 days a week from anywhere in the world at: http://www.irs.gov/irs/news.

# Changes to Illinois Taxation of College Savings Plans Effective in 2002

The Illinois General Assembly has enacted statutes providing for two different college savings plans intended to qualify for special tax treatment under IRC Section 529. The Illinois Prepaid Tuition Act (110 ILCS 979) was enacted in 1997, providing for Section 529 plans administered by the Illinois Student Assistance Commission. The College Savings Pool program is authorized by Section 16.5 of the State Treasurer Act (15 ILCS 505/16.5), effective January 1, 2000. The popular name given to the College Savings Pool program by the State Treasurer is the "Bright Start College Savings Program."

Both Illinois laws provide that earnings on the plans and distributions from the authorized plans in order to pay qualified expenses (such as tuition and book fees) are exempt from Illinois income taxation. These exemptions were effective even before IRC Section 529(c)(3)(B) was enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 to exempt distributions used for qualifying expenses. The Illinois income tax exemptions are effective regardless of whether the plans continue to qualify under IRC Section 529.

In 2001, Public Act 92-439 was enacted to provide that contributions to the Bright Start program on or after January 1, 2002, are deductible for Illinois income tax purposes. This deduction is allowed only for Bright Start, and not for the Prepaid Tuition Program or any other IRC Section 529 plan.

On July 11, 2002, Public Act 92-626 was enacted. It amends the Illinois Income Tax Act to provide that a contribution to the Bright Start program is not deductible to the extent it is comprised of income earned in another college savings plan that is exempt from federal income taxation because it is being rolled over into the Bright Start program.

Public Act 92-626 also provides that a distribution from a college savings plan that is exempt from federal income tax under IRC Section 529(c)(3)(B) will be subject to Illinois Income Tax except in the case of distributions from a Bright Start plan or a Prepaid Tuition Act plan. The changes in Public Act 92-626 are effective for tax years beginning on or after January 1, 2002.

In addition, the electronic methods of filing, e-File, PC File, and I-File, for tax year 2002 have been expanded to include the "**Bright Start**" modification reported on Form IL-1040.

## **IDOR Decouples from "Bonus Depreciation"**

On March 9, 2002, the Job Creation and Worker Assistance Act of 2002 was enacted as Public Law 107-147. That Act adds Section 168(k) to the Internal Revenue Code to allow "bonus depreciation" equal to 30 percent of the basis of qualified property placed in service on or after September 11, 2001, and on or before September 10, 2004. The bonus depreciation is taken in the year the qualified property is placed in service. It is taken after any IRC Section 179 expense is claimed and subtracted from basis, and the bonus depreciation is subtracted from basis before regular depreciation is computed on the property.

Any deduction allowed in computing a taxpayer's federal taxable income (or, in the case of an individual, adjusted gross income) is allowed in the same amount in figuring Illinois base income unless a specific provision of the IITA requires that deduction to be added back or modified. On June 28, 2002, the General Assembly enacted Public Act 92-603, which requires taxpayers to add back any bonus depreciation claimed for 2001 and all subsequent years.

The new Illinois Act also provides for refiguring of regular depreciation on an asset for which "bonus depreciation" was claimed. Because taking bonus depreciation on an asset reduces the adjusted basis of the asset claimed by 30 percent, regular depreciation on the asset will be only 70 percent of what it would have been had no bonus depreciation been claimed. The Act allows taxpayers to claim additional depreciation on such assets equal to 42.9 percent of the regular depreciation, because 42.9 percent of 70 percent equals the 30 percent reduction in regular depreciation that occurs when bonus depreciation is claimed. This additional depreciated for federal purposes.

Any gain or loss realized for federal income tax purposes on the sale of an asset is taken into account in the same amount for Illinois income tax purposes. Because of these changes in depreciation, however, the adjusted basis used to figure gain or loss on an asset should be higher for Illinois income tax purposes than for federal income tax purposes. To correct this discrepancy, Public Act 92-603 provides that in the year an asset is sold, all changes in its depreciation will be reversed. After this reversal, total Illinois depreciation on the asset will equal total federal depreciation, so the adjusted basis will be the same for Illinois and federal purposes.

All of these adjustments will be reported on Form IL-4562, Special Depreciation, which must be attached to the taxpayer's income tax return. If a taxpayer has filed an Illinois return or amended return on which bonus depreciation was taken into account, an amended return must be filed reporting the adjustments required by the new Illinois Act. If the amended return is filed on or before October 15, 2002, no penalty or interest will be imposed on the underpayment. Abatement of penalty and interest on returns filed after that date will be made on a case-by-case basis.

The Illinois Department of Revenue has recently published Informational Bulletin FY 2003-02, Illinois Decouples from Federal Law, which has been sent to all income tax preparers. To view a copy of this bulletin, visit our Web site at www.ILtax.com.

In addition, the electronic methods of filing, e-File, PC File, and I-File, for tax year 2002 have been expanded to include the "bonus depreciation" modifications as reported on Form IL-4562. This form must be attached to the electronic IL-1040 if the "bonus depreciation" is claimed on the 2002 electronic income tax return.

# Again this year You talked.....We listened!



The electronic filing tax rofessional community quested that the Illinois partment of Revenue R) extend the time for nitting electronic ) Individual Income

Tax returns to October 15.

We listened! The department will accept 2002 e-Filed, PC Filed, and I-Filed Illinois Individual Income Tax returns until midnight on October 15, 2003. The TeleFile filing date remains April 15, 2003.

Please advise your clients that this extension does not extend the time for paying any tax due. The due date for paying timely 2002 IL-1040 tax due is April 15, 2003.

# Thank you for a Successful 2002 Processing Season

The 2002 Individual Income Tax (IIT) processing season was a success, reflected by a 26.8 percent increase in electronically filed returns and a 13.3 percent increase in the number of 2D bar coded returns. The **Illinois Department of Revenue** (IDOR) surpassed its Individual Income Tax (IIT) electronic filing goal by processing over 1.6 million electronic returns (28.9 percent of IIT total).

In 2002, electronic filing programs were expanded to include Schedule CR and Form IL-2210. These two additions allowed 97 percent of Illinois taxpayers to participate in an electronic filing program.

Meanwhile, the department expanded the 2D bar code program to accept 2D returns with a Schedule-ED attached as well as returns received for deceased taxpayers.

The department asks tax practitioners to strongly encourage their clients who owe tax on their electronic Individual Income Tax returns to pay the amount they owe using the Electronic Funds Withdrawal payment option.

Thanks to tax practitioners for encouraging their clients to file electronically. In 2003, the department's goal will be to have one of every three IL-1040s filed through electronic filing.

# Attention Illinois Electronic 1040 Software Developers

Electronic Funds Withdrawal Option Right in Your Tax Filing Software

The Illinois Department of Revenue (IDOR) is asking developers of Illinois electronic 1040 software packages to include the electronic funds withdrawal option in their tax filing software. PC Software will be excluded from the electronic funds withdrawal option.

The specifications for electronic funds withdrawal are included in IDOR's 2002 Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns. You will soon find this information "in draft form" on our Web site at www.ILtax.com.

You will need a password to access drafts on IDOR's Web site. To receive your password, call the Electronic Filing Division,

1 866 440-8680.

# Attention Illinois Electronic 1040 Tax Practitioners

The Illinois Department of Revenue (IDOR) is asking tax practitioners to "strongly encourage" your clients that owe tax on their electronic 2002 Individual Income Tax Return to pay the amount they owe using the Electronic Funds Withdrawal payment option.

#### Visit IDOR at ILtax.com

The

Illinois Department of Revenue

(IDOR) has made it easier for you and your customers to access information via our Web site.

Just type in www.ILtax.com and you will go directly to IDOR's home page.

The Illinois Department of Revenue



## for Tax Professionals

#### Illinois e-File and PC File Changes

#### **Distribution Changes**

IDOR thanks all electronic filing tax professionals who supported "paperless" efforts last processing season by obtaining electronic filing booklets from their Web site. This effort was a huge success!

IDOR will continue to focus on expediting electronic filing information to you "the electronic way," by using their Web site, www.lLtax.com, as a communication tool.

#### **Information Changes**

IDOR's Web site will feature the following:

- Procedure for Electronic Filing of Individual Income Tax Returns (IL-1345) will contain the rules, regulations, and procedures.
- Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns (IL-1346) will contain only the file specifications and record layouts.
- Illinois Electronic Filing Test Package for 2002 IL-1040 Returns that (IL-1347) will contain only the testing information.
- Electronic Filing Error Reject Code Handbook (IL-1348) will contain form examples with sequence numbers and all error code explanations

# Transmitters of Electronic IL-1040s are Not Required to Test

Transmitters of electronic 2002 IL-1040, Individual Income Tax returns, are not required to test with IDOR, providing they use software that has been approved by the department.

Transmitters may opt to test to assure that no problems occur when transmitting "live" returns or picking up "live" acknowledgments. IDOR will provide transmitters with their test and production passwords in the same mailing.

#### Illinois Expands Electronic Filing

IDOR will accept the "Bonus Depreciation" addition and subtraction modifications reported on Schedule IL-4562, Special Depreciation, electronically when taxpayers file using e-File, PC File, and I-File. Schedule IL-4562 must accompany the electronic IL-1040 return if the special depreciation is claimed on the 2002 IL-1040. For details about these modifications, refer to the article 'IDOR Decouples from "Bonus Depreciation" on Page 5.

In addition, IDOR will accept the "Bright Start" modification reported on electronic Form IL-1040 for tax year 2002. This includes the e-File, PC File, and I-File filing methods. For details about this modification, refer to the article "Changes to Illinois Taxation of College Savings Plans Effective in 2002" on Page 4.

# Illinois uses "ZMODEM" Protocol for the 2003 Precessing Season

For the 2003 processing season, IDOR will no longer be using the XMODEM protocol. IDOR will be supporting the ZMODEM protocol for communications transmissions and acknowledgment pickups. ZMODEM details are provided in the Procedure for Electronic Filing of Individual Income Tax Returns.

This information will be located on IDOR's Web site at www.ILtax.com. If you do not have Internet access, you may call us at 217 524-4767.

# **New Look for IRS Web Site Garners Award for Innovation**

The **Internal Revenue Service's** (IRS) redesigned Web site continues to be a top attraction for both taxpayers and awards, logging more than 2 billion hits this fiscal year and gaining recognition for its improvements.

In June, e-Gov recognized the IRS with its Pioneer Award for innovative approaches to improving products and services. IRS.gov was one of 20 government sites awarded for in

was one of 20 government sites awarded for improvements. On June 26-27, IRS.gov officials gave a best-practice briefing and staffed an information kiosk during the e-Gov Exposition to share experiences with other government officials.

The updated IRS.gov recently ranked number one as the Web's top searched-for site in the "Lycos 50."

Launched Jan. 28, the new IRS.gov was intended to make the Web site more user friendly. The design is intended to allow visitors to find their information within a few clicks, to quickly locate tax forms and publications for download and to get fast responses to frequently asked questions (FAQs).



The new site is organized by the following categories:

- Individuals
- Businesses
- Charities and Non-Profits
- Government Entities
- Tax Professionals
- Retirement Plans

IRS.gov contains a huge volume of public documents, some 90,000 pages of content. To help visitors reach their destination, IRS.gov offers an enhanced search capability and easier navigation tools. The cleaner design also means faster downloads.

IRS.gov is one of the most visited sites on the World Wide Web. Since the 2002 fiscal year began last October, IRS.gov has had more than 2 billion hits. On April 15, the site's pages logged 78 million hits during a 24-hour period. Visitors also downloaded more than 200 million files.

## **New Tax Scams Page Debuts on IRS.Gov**

Keeping taxpayers alerted to the latest scams, the **Internal Revenue Service** (IRS) has created an updated Criminal Investigation Web page on schemes and cons.

The redesigned page on Tax Fraud Alerts is the latest IRS effort to combat tax schemes. The site is available by visiting *www.irs.gov* and using the home page link "Tax Scams/Fraud Alerts."

"Identifying and combating actively promoted tax schemes is our highest compliance priority. One reason is the money lost to the Treasury, which is clearly substantial. But, even more important, these promoted schemes are unfair and corrosive to the health of our tax system," said Charles O. Rossotti, IRS Commissioner.

"Nothing undermines confidence in the tax system more than the impression that the average honest taxpayer has to pay his or her taxes while unscrupulous taxpayers are allowed to get away with not paying," Rossotti added. The updated Tax Fraud Alerts page provides taxpayers links to such news items as recent civil and criminal actions against scam promoters and participants by the Department of Justice. The page also links taxpayers to recent IRS news items about the agency's enforcement efforts and warnings about common tax scams. For example, the IRS "Dirty Dozen" news release includes information on such cons as false slavery reparations that promises African Americans a huge rebate or the scam that claims Social Security withholdings are refundable.

The IRS warns taxpayers to beware of the tax-savings pitch that sounds too good to be true. Taxpayers should seek expert advice before they subscribe to any scheme that offers promises of instant wealth or exemption from taxes. This new page will help protect taxpayers by keeping them informed.

### **IDOR Expands EFT Program**



# Excise Taxes Have Been Added to the Electronic Funds Transfer Program

Public utility, hotel/motel, telecommunication, gaming, dry cleaning, liquor, and cigaratte taxes, commonly referred to as excise taxes.

have been added to the EFT program. Recent 2002 legislation required the **Illinois Department of Revenue** (IDOR) to expand the Electronic Funds Transfer (EFT) application to include excise taxes as well as centralizing statutory language in the Administrative Code. Effective January 1, 2003, taxpayers filing excise tax who have an average liability of \$200,000 or more per tax type will be required to

submit those tax payments by EFT. In addition, taxpayers filing Telecommunications tax returns with an annual liability of \$12,000 or more are required to remit their payments by EFT.

Taxpayers who are required to remit tax payments through EFT must initiate the payment so that the amount due is deposited in the department's account on or before the due date to avoid a late penalty. For more information, visit the Illinois Department Of Revenue's web-site at www.ILtax.com or telephone the department's Electronic Funds Transfer Division at 1800 732-8866.

### **Taxpayers Must Make Choice by October 31**

# IRS Gives Taxpayers Until October 31 to Make Choice on New 5-Year Carryback for Net Operating Losses

The **Internal Revenue Service** (IRS) will allow taxpayers until October 31, 2002, to choose whether or not they want to use the new five-year carryback period for net operating losses (NOLs) that was part of a tax law enacted in March.

The new law made the extended carryback period effective for tax years ending in 2001 or 2002, but some taxpayers who filed returns before the law was passed would not have been able to use this provision.

The Congressional tax-writing committees have advised the Treasury Department that this was not their intent, and that they will pursue technical corrections legislation to let tax-payers take maximum advantage of the carryback period. IRS procedures reflect that clarification.

Taxpayers that incurred an NOL but either elected to forgo any carryback period or used a two-year period when they filed can switch to the five-year period and claim a quick refund until October 31, even though they would not usually have been able to do so. Those who want their return to remain as they filed it need not do anything.

Taxpayers that neither elected to forgo the carryback period nor used a two-year period may choose to relinquish the fiveyear period and apply a two-year period.

Revenue Procedure 2002-40 has details on what taxpayers should do in each situation. It was published in IRB 2002-23, dated June 10, 2002. It can found on the IRS Web site at: www.irs.gov/pub/irs-drop/rp-02-40.pdf

Revenue Procedure 2002-33, explaining how to claim the additional depreciation and certain Liberty Zone benefits if not originally claimed on returns filed before June 1, was published in Internal Revenue Bulletin 2002-20, dated May 20, and is on the IRS Web site at: www.irs.gov/pub/irs-drop/rp-02-33.pdf.

## IDOR's E-Connection Available Electronically

The Illinois Department of Revenue's (IDOR) Electronic Filing Division periodically publishes a newsletter to increase communication with Electronic Return Originators and Software Developers. This newsletter is one-page and keeps you abreast of any processing alerts, revisions to our forms, processing changes, law changes, *etc*.

IDOR's favorite way to distribute the newsletter is through e-mail. If you would like to be on our E-Connection Newsletter distribution list, give us a call on our toll-free number, **1 866 440-8680** (exclusively for tax professionals) and provide us with your e-mail address.

For those of you already on our distribution list – if you change providers or change your e-mail address, **please** remember to provide us with the changes.

## IRS Provides Guidance for Taxability of Demonstration Automobiles to Salespersons

Over 85,000 taxpayers may be impacted by Revenue Procedure 2001-56, which governs the tax treatment of demonstrator automobiles (demos) provided by auto dealers to their employees.

The Internal Revenue Service developed Revenue Procedure 2001-56 as a result of the IRS's Industry Issue Resolution (IIR) Pilot Program which was designed to resolve issues common to many large business taxpayers. Affected taxpayers may include new and used car dealerships as well as the salespersons to whom they provide demo autos. A demo is an automobile that is currently in the inventory of the dealership and available for test-drives. In addition to automobiles, a demo could be a passenger van, sport utility vehicle, or a light duty truck (a Class 1,2 or 3 truck with a gross vehicle weight of 14,000 pounds or less).

Revenue Procedure 2001-56 serves two main purposes. First, it clarifies the existing full exclusion rules regarding demos. Secondly, it provides taxpayers with three new, optional, simplified methods of determining the value of the use of demos automobile dealerships provide to their employees. The three new methods include methods to 1) fully exclude qualified demo use (Simplified Out/In Method); 2) partially exclude demo use by full-time salespeople; 3) include the value of the demo when no exclusion applies. In addition, the Revenue Procedure includes guidance on how to apply the general rule when methods in the Revenue Procedure are not used.

The Revenue Procedure sequentially structures the demo methods. If an employee does not qualify under the first method, the employee moves to the second, and so forth. The full and partial exclusion methods require a dealership to implement a specific written policy statement on demo use.

Revenue Procedure 2001-56 also contains a limited error correction mechanism. Provided that all other requirements are met, a dealership may still use the methods in the Revenue Procedure if it identifies and corrects an inclusion amount error in the same year the dealership provided the demo to its employee. If the dealership does not correct the inclusion during the calendar year, it must compute the employee's inclusion amount using the general valuation and substantiation rules.

Revenue Procedure 2001-56 is effective for taxable years beginning on or after January 1, 2002. Additional information is available on the IRS Web site at www.irs.gov.

# IRS Reduces Paperwork Burden on Small Businesses

Tax documentation constitutes the overwhelming majority of paperwork requirements for most small businesses. Beginning with tax year 2002, companies with less than \$250,000 in gross receipts and less than \$250,000 in assets will no longer be required to complete Schedules L, M-1 and M-2 of Form 1120; Parts III and IV of From 1120-A; and Schedules L and M-1 of Form 1120S.

#### What are these forms?

- Schedule L (Part III of Form 1120-A) provides the beginning and end-of-year balance sheets based on the corporation's books.
- Schedule M-1 (Part IV of Form 1120-A) provides reconciliation of income or loss in accounting records with income or loss on the tax return.
- Schedule M-2 reflects unappropriated retained earnings.

For larger companies, these schedules are necessary tools in the examination of corporate returns. For most small businesses, however, these schedules have a limited application, and would likely not be prepared if they were not required for tax reporting purposes. The exemption for small businesses will allow them to use record keeping based on their checkbook or cash receipts and disbursements journal instead of additional accounting methods solely for tax reporting.

According to IRS Commissioner Charles O. Rossotti, "These changes could save 2.6 million small businesses an estimated 61 million staff hours. This is staff time now spent preparing these forms. These changes will mean a significant financial savings for small businesses. This is part of an on-going effort by he IRS to ease the burden on America's taxpayers wherever possible."

For more information, visit the IRS Web site at www.irs.gov.

# Are You Getting the Credit You Deserve? Here's a Tip.

If you are a practitoner for an employer in the food and beverage industry, your client may be entitled to a credit for the social security and Medicare taxes he pays on his employees' tip income. This credit is available under *Internal Revenue Code* (*IRC*) Section 45 B, Credit For Portion Of Employer Social

Security Paid With Respect To Employee Cash Tips. Both of the following requirements must be met to qualify for the credit:



The employer had employees who received tips from customers for providing, delivering, or serving food or beverages for consumption; and



The employer paid or incurred employer social security and Medicare taxes on these tips.

The credit applies only to tips received by food and beverage employees. It is not applicable to other tipped employees.

The *IRC Section 45 B* credit is available for taxes paid after December 31, 1993. The credit is available without regard to whether the employees reported the tips to the employer pursuant to *IRC Section 6053(a)*. Employers can claim or elect not to claim the credit anytime within three years from the due date of their return on either the original return or an amended return.

#### **Minimum Wage Effect**

The credit equals the social security and Medicare taxes the employer paid on the tips received by the employees. However, no credit is given for tips used to meet the federal minimum wage rate of \$5.15 per hour. For example, if the employee was paid \$3.75 per hour and applied tips of \$1.40 per hour to reach the \$5.15 minimum wage, then the \$1.40 per hour in tips cannot be used toward the credit. If, however, each employee was paid an amount equal to or more than the minimum wage without including tips, then the credit can be computed on all reported tips. If the state minimum wage is different, it takes precedence over the federal minimum wage. You may want to visit www.dol.gov/dol/esa/public/minwage/america.htm to determine your state's minimum wage.

#### Treatment of IRC 45B credit

The credit is part of the general business tax credit and is claimed on Form 8846, Credit for Employer Social Security and Medicare Taxes on Certain Employee Tips. Since it is an income tax credit, claimed on an income tax return, it may be used to offset any regular income tax liability, **but not employment tax liabilities**. A credit is a dollar for dollar reduction of your regular tax liability, where an expense deduction only reduces your taxable income. Therefore, credits

are usually more beneficial. You cannot claim both the credit **and** the expense deduction. If you claim the credit, you must reduce your social security and Medicare tax deduction accordingly. You should evaluate with your client annually, whether the credit or the expense deduction is more beneficial to him.

The *IRC* 45B credit is not refundable which means if the credit reduces your client's regular income tax below zero, to a negative amount, the negative amount is not sent to him as a tax refund. However, it is subject to carry back and carry forward provisions of the Internal Revenue Code, as are other components of the business tax credit. *See IRC Section* 39. Credits arising in tax years beginning after December 31, 1997 may be carried back one year and forward 20 years. Credits arising in tax years beginning before 1998 may be carried back three years and forward 15 years. If you intend to carry back or carry forward your *IRC Section* 45B credit, you must use Form 3800.

## IRS Tests New Procedures to Speed Technical Advice Process

The **Internal Revenue Service** (IRS) announced that it is testing a pilot program to streamline the process for issuing technical advice in audit situations.

During the pilot, the new product, called a Technical Expedited Advice Memorandum (TEAM), will be limited to income tax and accounting issues. If successful, the TEAM process will expand to all tax issues.

The IRS expects to issue TEAMs within a 60-day period. Currently, technical advice should be issued within 120 days, but about 40 percent of pending requests are older than that, with some approaching one year.

The taxpayer and the IRS agent or appeals officer must agree that the issue is appropriate for the TEAM process. If not, the IRS will handle the issue under existing procedures.

One TEAM innovation is that if the taxpayer and the auditor do not agree on the facts of the case, Chief Counsel may issue two separate answers - one based on the taxpayer's submission of facts and the other based on the auditor's. In such cases, the IRS field office will not be bound by the findings of the TEAM.

The TEAM process will make liberal use of technology - including fax, e-mail, and teleconferences - to minimize expenses and burdens for taxpayers and the service.

Details on the TEAM pilot are in Revenue Procedure 2002-30, which was published in IRB 2002-24, dated June 17, 2002. It is also available on the IRS Web site at: http://www.irs.gov/pub/irs-drop/rp-02-30.pdf.

### **IRS Offers Faster Resolution of Tax Disputes**

Small business and self-employed taxpayers can now resolve tax disputes through fast-track mediation offered by the **Internal Revenue Service** (IRS). Disputes will be resolved through the new expedited process within 40 days compared to several months through the regular appeal process.

Either the taxpayer or the IRS Small Business/Self-Employed Division can propose mediation of disputed issues related to examinations or collection actions. If both parties agree to mediation, a specially-trained IRS mediator from the Appeals Division helps resolve the dispute. The mediator facilitates discussion, and may request additional information, but cannot impose a resolution. The taxpayer and IRS must agree on any resolution.

"A primary focus in the IRS reorganization has been to develop systems and processes that improve service to the taxpayer. Fast-track mediation is geared to meet taxpayer needs by resolving controversy at the earliest resolution point within the IRS. Fast-track mediation is what modernization is all about," said Joseph Kehoe,

IRS Commissioner for the Small Business/Self-Employed Division.

In June 2000, IRS began testing fast-track mediation primarily in four areas of the country: Hartford, Jacksonville, Houston and Denver. The test showed that the process can shorten the time it takes to resolve a tax dispute. Feedback provided by taxpayers and their representatives indicated an overall satisfaction rate of 4.2 on a scale of 5.0.

The taxpayer does not give up any rights and can withdraw from mediation at any time. Issues not resolved during the mediation process can follow the normal IRS appeal process. Certain issues, including Service Center appeals, or those issues with no legal precedent, cannot be addressed in fast-track mediation.

For additional information on fast-track mediation, visit the IRS Web site at **www.irs.gov** and click on "Businesses" on the left side. From the Businesses page, select "Small Business/Self-Employed" on the left. From the Small Business/Self-Employed page, scroll down and select "Fast-Track Mediation."

### IRS INCREASES PERFORMANCE SCORE

The **Internal Revenue Service** (IRS) gained recognition for its on-going improvement efforts as the Federal Performance Project gave the agency an overall grade of B minus, up from a C average in 1999.

The Federal Performance Project seeks to provide an independent management assessment of federal agencies. The program is collaboration between Government Executive magazine and George Washington University's public administration department. It is funded by the Pew Charitable Trusts.

"The Federal Performance Project score is just the latest indication of the change underway at the agency. Public opinion surveys also indicate improvements in the way people view the IRS," said Charles O. Rossotti, IRS Commissioner. "We certainly are not satisfied with a B minus, but the trend is in the right direction."

The Federal Performance Project gave the IRS an overall grade of B minus. It also graded individual areas such as managing for results, human resources, information, and finances. Driving the improved overall grade was the information technology sector, which improved to a C from a D. The project cited IRS e-file and the IRS.gov Web site as models of e-government.

The highest rated area for the IRS was managing for results, which received a grade of B. The report cited the IRS's clearly stated mission, well-defined goals, bimonthly performance reviews, and new performance measures as positives. Overall, the report noted that negatives such as decreased employee satisfaction, problems with computer systems and lack of management flexibility remain a problem.

Since the IRS began its reorganization efforts, the Roper Starch surveys have shown public approval on the upswing for the past three years. And, the University of Michigan's American Customer Satisfaction Index recently showed the IRS had the largest favorable gain of the 30 agencies surveyed.

## IRS Announces 2003 Standard Mileage Rates

The **Internal Revenue Service** (IRS) announced the optional standard mileage rates to use for 2003 in computing the deductible costs of operating an automobile for business, charitable, medical or moving expense purposes.

The amounts for the various deductible costs for use of a car will be effective January 1, 2003, and are as follows:

- The standard mileage rate for the use of a car for business purposes is 36 cents a mile for all business miles driven, down from 36.5 cents a mile in 2002.
- The standard mileage rate for the use of a car when giving services to a charitable organization remains at 14 cents a mile.
- The standard mileage rate for the use of a car for medical reasons is 12 cents a mile, down from 13 cents a mile in 2002.
- The standard mileage rate to use when computing deductible moving expenses is 12 cents a mile, down from 13 cents a mile in 2002.

The standard mileage rates for business, medical and moving purposes are based on an annual study of the fixed and variable costs of operating an automobile. The primary reason for the mileage rate decreases is the decline in fuel prices during the study period, which ended on June 30. An independent contractor conducted the study on behalf of the IRS. The charitable standard mileage rate is set by law.

Revenue Procedure 2002-61 contains additional information on these standard mileage rates. It will appear in Internal Revenue Bulletin 2002-39, dated September 30, 2002. It will also be available through the "Advance Notice for Tax Professionals" section of the IRS Web site at www.irs.gov.

## Teachers Should Save Receipts for New Tax Deduction

The Internal Revenue Service (IRS) is advising teachers to save their receipts for purchases of books and classroom supplies. These out-of-pocket expenses may lower their taxes, thanks to a recent change in the law.

The new law gives teachers a tax break even if they do not itemize deductions on Schedule A, Form 1040. This special adjustment to income is for expenses paid or incurred in tax years beginning during 2002 or 2003.

Previously, these expenses were deductible only as a miscellaneous itemized deduction subject to the 2 percent of adjusted gross income limit. Educators may subtract up to \$250 of qualified expenses when figuring their adjusted gross income (AGI).

The new deduction is available to eligible educators in public and private elementary and secondary schools. They must work at least 900 hours during a school year as a teacher, instructor, counselor, principal, or aide.

Teachers who excluded education savings bond interest or payments from qualified tuition programs, or made tax-free withdrawals from an education savings account, will be able to claim the new deduction only to the extent their qualified expenses exceed the tax-free amounts.

The IRS suggests that educators keep records of qualifying expenses in a folder or envelope with a label such as "Educator Expenses Deduction," noting the date, amount, and purpose of each purchase. This will help prevent a missed deduction at tax time.

The new tax law changes are detailed in IRS Publication 3991, Highlights of the Job Creation and Worker Assistance Act of 2002, available on the IRS Web site at: http://www.irs.gov/pub/irs-pdf/p3991.pdf.

# Enhanced Schedule K-1 Compliance Effort In Effect

The **Internal Revenue Service** (IRS) has launched an enhanced compliance effort to encourage taxpayers to properly report partnership, S corporation, or trust income or losses on their individual tax returns. Some taxpayers may soon receive notices requesting an explanation for a discrepancy.

The IRS earlier this year began matching information reported on Schedule K-1 with income or losses reported on Form 1040 and other schedules. The IRS will send notices to taxpayers when there is a mismatch in information provided on tax year 2000 returns. In many cases, the taxpayer or tax professional can resolve the issue with a letter or phone call.

"One of the most powerful tools that we use to ensure compliance is matching information received from employers, financial institutions, and other businesses with information reported by taxpayers," said Charles O. Rossotti, IRS commissioner. "Third parties report approximately 80 percent of the personal income received by taxpayers. An important compliance strategy is to use this data as effectively as possible."

Partnerships, S corporations, and trusts are not taxable entities. Taxes on their net profits or losses are levied, in general, directly on partners, shareholders, or beneficiaries. These flow-through entities must file information returns with the IRS and also must provide to members or shareholders a Schedule K-1, which details an individual's share of profits, losses, deductions or credits.

The IRS processed more than 18 million Schedule K-1 forms for tax year 2000, recording \$1.2 trillion in income to partners, stockholders, and beneficiaries. A computer program matches Schedule K-1 information. To date, some 65,000 notices have been issued in which the computer found a mismatch between the information return and the individual's tax return.

"The IRS is committed to refining the process. We will continue to work with the practitioner community to provide on-going status reports and to solicit feedback for program enhancements," said Joe Kehoe, commissioner of the Small Business and Self-Employed Division.

# Pricewaterhouse Coopers LLP and IRS Combine Efforts

The Internal Revenue Service (IRS) has reached an agreement with Pricewaterhouse Coopers LLP to resolve issues relating to tax shelter registration and list maintenance under the Internal Revenue Code.

Without admitting or denying wrongdoing or legal liability under the Internal Revenue Code penalty provisions,

PricewaterhouseCoopers LLP agreed to make a substantial payment to the IRS to resolve issues in connection with advice rendered to clients dating back to 1995.

PricewaterhouseCoopers LLP has agreed to provide certain client information pursuant to authorized legal processes, such as summonses, to the IRS as required by law and, significantly, to work with the IRS to develop processes to ensure ongoing compliance with the Internal Revenue Code and Treasury Regulations for registering tax shelters and maintaining lists of investors in tax shelters.

In an effort to perfect the matching program, IRS examiners are manually screening returns to ensure consideration of issues such as passive loss limitations and income or losses reported on Schedule E. A notice is generated when the examiners are unable to determine the cause of the discrepancy.

The Schedule K-1 forms are among the more than 1.4 billion information returns that the IRS processes. The Schedule K-1 matching program is more complex than the matching program for Form W-2 and Form 1099 documents because a K-1 lists multiple sources of income such as interest, dividends, capital gains, and losses. The K-1 information is matched along with other information documents to ensure that all types of income are documented.

## **Tax Incentives for Renewal Communities**

The **Internal Revenue Service** (IRS) states that the Department of Housing and Urban Development (HUD) recently announced 40 communities around the country that will be designated Renewal Communities (RCs), eligible to share in an estimated \$17 billion in tax incentives to stimulate job growth, promote economic development, and create affordable housing. Chicago is one of these Renewal Communities.

For tax professionals in these areas that may receive inquiries about available tax incentives, here's a brief summary:

Wage Credits – Businesses are able to hire and retain RC residents and apply the credits against their federal tax liability. Businesses located within the new RC can receive up to a \$1,500 credit for every newlyhired or existing employee who lives in the RC.

Work Opportunity Credits provide businesses located within RCs up to \$2,400 against their federal tax liability for each employee hired from groups with traditionally high unemployment rates or other special employment needs, including youth who live in the RC.

Welfare to Work Credits offer RC businesses a credit of up to \$3,500 (in the first year of employment) and \$5,000 (in the second year) for each newly hired long-term welfare recipient.

#### **Commercial Revitalization Deductions**

permit a state with one or more RCs to deduct \$12 million per RC per year, up to \$10 million per project for commercial or industrial buildings developed in the RCs. A business can deduct up to \$5 million in the year the building is placed in service or deduct the full amount of eligible expenditures pro rata over 10 years.

Section 179 Deductions allow a qualified RC business to expense up to \$35,000 of additional qualified property such as equipment and machinery acquired each year during the period of the RC designation, 200 2 through 2009.

**Environmental Cleanup Cost Deductions** allow businesses to deduct qualified cleanup costs in Brownfields.

Zero Percent Capital Gains Rate applies to an interest in, or property of, certain businesses operating in an RC, if the asset is acquired during the period of the RC designation and held for at least 5 years.

IRS Publication 954, Tax Incentives for Empowerment Zones and Other Distressed Communities, addresses the federal tax benefits: http://www.irs.gov/pub/irspdf/p954.pdf

There's more information on Renewal Communities on the HUD Web site at:

http://www.hud.gov/offices/cpd/ezec/index.cfm. (%)



#### IRS Moves to Clarify Taxpayer Deduction for Hybrid Vehicles

Recently, the **Internal Revenue Service** (IRS) issued a revenue procedure that will help determine the deduction allowed to individuals who are the original purchasers of one of the new hybrid gas-electric automobiles entering the market.

Federal tax law allows individuals to claim a deduction for the incremental cost of permitting a motor vehicle to be propelled by a clean-burning fuel. The electricity in the hybrid gas-electric vehicles is a clean-burning fuel. By combining an electric motor with a gasolinepowered engine, these hybrid vehicles obtain greater fuel efficiency and produce fewer emissions than similar vehicles powered solely by conventional gasolinepowered engines.

The amount of the deduction depends on the particular hybrid automobile being purchased. It will be set in the coming months after manufacturers document for the IRS, under the process specified in Revenue Procedure 2002-42, the incremental cost of each vehicle's electric motor and related equipment. This incremental cost will provide the basis for a onetime deduction of up to \$2,000 in the year the vehicle is first used.

Individuals take this benefit as an adjustment to income. They do not have to itemize deductions on their tax returns to claim it. Once set, the deduction would apply not only to returns being filed for tax year 2002, but also for the previous two years for which such hybrid vehicles were available. The deduction could be claimed for a past year by a taxpayer filing an amended return.

Revenue Procedure 2002-42 can be reviewed at: http:// www.irs.gov/pub/irs-drop/rp-02-42.pdf.

## **Illinois Legislative Recap**

New laws enacted in the 2002 session of the 92nd Illinois General Assembly that affect taxes administered by IDOR include:

#### **Income Tax**

#### SB 1543, Public Act 92-603

Effective upon becoming law: Senate Bill 1543 amends the Illinois Income Tax Act, to "decouple" from federal income tax statutes for purposes of the accelerated depreciation schedule beginning with tax year 2001. The Use Tax Act, the Service Use Tax Act, the Service Occupation Tax Act, and the Retailers' Occupation Tax Act are also amended to extend the aggregate mining sales & use tax exemption another 5 years.

#### SB 2212, Public Act 92-846

Effective upon becoming law: Senate Bill 2212 makes several technical chanbes to the Illinois Income Tax Act. It provides that, each year, a nonresident taxpayer may make an election to treat all income as business income apportioned to Illinois by formula, rather than allocated to specific sources. It also provides that an agreement between IDOR and a partnership or Subchapter S corporation to extend the statute of limitations for deficiencies or refunds automatically extends the statute of limitations for changes that flow through to the partners or shareholders.

#### HB 4187, Public Act 92-626

Effective upon becoming law: House Bill 4187 amends the Illinois Income Tax Act, to provide for tax years beginning on or after January 1, 2002, an individual's adjusted gross income (AGI) must be increased by the amount excluded from his/her federal gross income for distributions from tuition programs, other than the College Savings Pool or the Illinois Prepaid Tuition Trust Fund. House Bill 4187 further provides that the deduction from an individual's AGI for contributions to a College Savings Pool account does not apply to amounts excluded from his or her federal gross income.

#### HB 4230, Public Act 92-772

Effective upon becoming law: House Bill 4230 amends the Illinois Income Tax Act to create the Multiple Sclerosis Assistance Fund checkoff, beginning for tax years ending on or after December 31, 2002. The new Multiple Sclerosis checkoff is created consistent with the provisions of all other checkoffs on the IL-1040. The Department of Human Services Act is also amended to provide that, subject to appropriation, the Department of Human Services shall make grants from the Multiple Sclerosis

Assistance Fund for health-related programs for people with multiple sclerosis. Grants are to be made to only organizations that are located in the State of Illinois. The Multiple Sclerosis

Assistance Fund is created in the State Finance Act.

#### Sales and Excise Tax

#### SB 1760, Public Act 92-779

Effective Upon Becoming Law: Senate Bill 1760 amends the Retailers' Occupation Tax Act to make changes to the Enterprise Zone Building Materials Exemption. Senate Bill 1760 defines "qualified sales" as a sale of building materials that will be incorporated into real estate as part of a building project for which a Certificate of Eligibility for Sales Tax Exemption has been issued by the administrator of the enterprise zone in which the building project is located. Senate Bill 1760 further provides a method by which qualified sales may be made by any retailer, without regard for the retailer's proximity to an enterprise zone.

#### SB 2017, Public Act 92-737

Effective Upon Becoming Law: Senate Bill 2017 creates the Tobacco Product Manufacturers' Escrow Enforcement Act to provide that a distributor of cigarettes may not affix, or cause to be affixed, tax stamps to individual packages of cigarettes delivered or caused to be delivered by the distributor in this State if the manufacturer of those cigarettes has (i) failed to become a participating manufacturer under the Tobacco Product Manufacturers' Escrow Act or (ii) failed to create a qualified escrow fund for any cigarettes manufactured by the tobacco product manufacturer and sold in this State or otherwise failed to bring itself into compliance with certain provisions of the Tobacco Product Manufacturers' Escrow Act. Further, Senate Bill 2017 provides that a distributor (including distributors of roll-your-own tobacco) who violates the Act is subject to the revocation, cancellation, or suspension of his/her license under the Tobacco Products Tax Act of 1995, the Cigarette Tax Act or the Cigarette Use Tax Act, as appropriate. Senate Bill 2017 further authorizes the Attorney General, in consultation with the Department of Revenue to adopt rules to effectuate compliance with the Act and the Tobacco Product Manufacturers' Escrow Act.

### Illinois Legislative Recap (Continued)

The Cigarette Tax Act, and the Cigarette Use Tax Act are amended to make corresponding changes.

#### SB 2037, Public Act 92-739

Effective January 1, 2003: Senate Bill 2037 amends the Illinois Municipal Code to require the Department of Revenue, beginning on October 1, 2002, to administer and enforce certain non-home rule municipal occupation and use taxes beginning on (i) the first day of July if a certified copy of the ordinance or resolution concerning the tax is delivered to the Department on or before the first day of April or (ii) the first day of January if a certified copy of the ordinance or resolution concerning the tax is delivered to the Department on or before the first day of October.

Senate Bill 2037 further provides that the Retailer's Occupation Tax, the Service Occupation Tax, and the Use Tax imposed by non-home rule municipalities under the Illinois Municipal Code shall not be imposed at a rate greater than ½ percent and shall be imposed only in 1/4 percent increments. Finally, this measure provides that the proceeds from these three taxes may also be used for municipal property tax relief. "Property tax relief" is defined in the bill as the action of a municipality to reduce the levy for real estate taxes or to avoid an increase in the levy for real estate taxes that would otherwise have been required.

#### SB 2211, Public Act 92-743

Effective Upon Becoming Law: Senate Bill 2211 amends the Tobacco Products Tax Act of 1995 to provide that any duly authorized employee of the Department of Revenue (i) may arrest without warrant any person committing in his or her presence a violation of any of the provisions of the Act (ii) and may without a search warrant inspect all tobacco products located in any place of business and seize any tobacco products and any vending device in which those tobacco products are found. Senate Bill 2211 provides that the tobacco products or vending devices so seized shall be subject to confiscation and forfeiture under the Act. Senate Bill 2211 also provides procedures for the seizure, forfeiture, and sale of tobacco products found to be in violation of the Act.

#### HB 539, Public Act 92-536

Effective Upon Becoming Law: House Bill 539 amends the Cigarette Tax Act and the Cigarette Use Tax Act to increase the cigarette tax an additional 40 cents/pack, beginning July 1, 2002. Between the effective date of this Act and June 30, 2002, distributors were allowed to pur-

chase only 115 percent of their average monthly purchases for the proceeding 12-month period. No floor stock tax was required. HB 539 also changes the distributions of current collections of the Real Estate Transfer Tax as follows: 20 percent (rather than current 35 percent) paid to Open Space Lands Acquisition Fund, and 5 percent (rather than current 15 percent) paid to the Natural Areas Acquisition Fund. The additional 25 percent spun off of these two funds will now be deposited to GRF.

#### HB 4974, Public Act 92-680

Effective Upon BecomingLaw: House Bill 4974 amends the Illinois Vehicle Code to change the name of the "drive-away decals" to "drive-away permits." House Bill 4974 further provides that the Secretary of State shall prescribe how drive-away permits are displayed and the process for obtaining a drive-away permit. The length of time that a short-term permit or a drive-away permit is valid is changed to 7 days. House Bill 4974 also amends the Use Tax Act and the Retailers' Occupation Tax Act to reflect the change in the name of the drive-away permits.

#### HB 5686, Public Act 92-600

Effective July 1, 2002: See listing under Miscellaneous/Tax Administration.

#### HB 6012, Public Act 92-602

Effective Upon Becoming Law: House Bill 6012 amends the Simplified Municipal Telecommunications Tax Act to create an extensive dispute resolution procedure for consumers that believe they are being improperly charged a local telecommunications tax.

# Circuit Breaker Pharmaceutical Assistance

#### SB 2098, Public Act 92-594

Effective Upon Becoming Law: Senate Bill 2098 creates the Senior Pharmaceutical Assistance Review Committee, which is to include the Director of Revenue or his/her designee, to gather information and advise State agencies concerning pharmaceutical assistance for Illinois seniors. Senate Bill 2098 further creates the Senior Health Assistance Program within the Department on Aging to provide outreach and education to seniors on available prescription drug programs, and requires the Illinois

(Continued on Page 18)

### Illinois Legislative Recap (Continued)

Comprehensive Health Insurance Board to study a catastrophic pharmaceutical assistance coverage option. Senate Bill 2098 requires reports to General Assembly and Governor.

#### HB 4937, Public Act 92-699

Effective Upon Becoming Law: Amends the Illinois Vehicle Code (IVC) and the State Finance Act to provide that, beginning with the 2004 registration year, the \$24 annual motor vehicle registration fee for persons who have claimed and received a grant under the Senior Citizens and Disabled Persons Property Tax Relief and Pharmaceutical Assistance Act applies to the types of special plates issued to veterans or their surviving spouses, parents, or siblings for which a fee is required (as well as to standard plates displayed on those vehicles). Other unrelated provisions for special plates, under the IVC are also included in House Bill 4937.

#### HB 4580, Public Act 92-597

Effective July 1, 2002: House Bill 4580 creates the FY2003 Budget Implementation Act. House Bill 4580 provides that the purpose of the Act is to make the changes in State programs that are necessary to implement the Governor's FY2003 budget recommendations. Among other changes not affecting the Department of Revenue, this Act provides, beginning July 1, 2002, the reimbursement rate paid for products and professional dispensing fees under the Pharmaceutical Assistance program shall be determined by rule, promulgated by the Department of Revenue.

# Miscellaneous Tax Administration

#### Senate Bill 1649 - Public Act 92-610

Effective Upon Becoming Law: Senate Bill 1649 amends the Illinois Petroleum Education and Marketing Act to provide that assessments to fund the Illinois Petroleum Resources Board shall be imposed on persons who own an interest in the gross production of oil or gas produced from a well in Illinois rather than from a person who derives the majority of his or her income from a working interest or who produces oil and gas. Senate Bill 1649 further provides for the con-

tinued existence of the Illinois Petroleum Resources Board until January 1, 2008, the scheduled sunset date for the Act.



#### Senate Bill 2209 - Public Act 92-742

Effective Upon Becoming Law: Senate Bill 2209 amends the Uniform Penalty and Interest Act, with respect to penalties for late payment or nonpayment of admitted liability. Senate Bill 2209 provides that if notice and demand is made for the payment of any amount of tax due and if the amount due is paid within 30 days after the date of the notice and demand, the penalty for late payment or nonpayment of admitted liability on the amount so paid shall not accrue for the period after the date of the notice and demand. This change allows the tiered penalties to coincide with the calculation and imposition of interest.

#### House Bill 5686 - Public Act 92-600

Effective Upon Becoming Law and July 1, 2002: House Bill 5686 provides that the purpose of the Act is to make changes relating to State finances that are necessary to implement the State's FY2003 budget. House Bill 5686 establishes income tax offset for the Income Tax Refund Fund of 8 percent and 27 percent for FY03. House Bill 5686 further redirects sales tax on photoprocessing currently deposited in LGDF, to GRF. House Bill 5686 reduces distribution of the Hotel Operators' Occupation Tax to the International Tourism Fund, from 6 percent of the 60 percent collected to 4.5 percent of the 60 percent. House Bill 5686 also creates a new assessment on electric utilities totaling \$5.5 million, annually, to be paid by July 31, to the Department of Revenue, for deposit in the Public Utility Fund. This new assessment is effective through January 1, 2009. The Illinois Commerce Commission (ICC) is to notify the Department of Revenue of the pro rata share to be collected from the affected electric utilities. Any unpaid liability is reported to ICC for action against the utility's ICC issued license. House Bill 5686 also allows state agencies a 3 percent transfer authority for FY03 (rather than a 2 percent transfer authority).

## **IRS Announces New Bankruptcy Addresses and Contact Numbers**

#### for Northern District of Illinois

Practitioners and taxpayers who need to communicate with or to send documents to Internal Revenue Service (IRS) officials handling bankruptcy matters in the Northern District of Illinois will find that some of their former contact numbers and addresses are no longer valid. Recent reorganizations of the IRS and the Office of Chief Counsel have changed the duties and titles of several officials and have shifted responsibility for handling certain bankruptcy cases to new managers and employees. Two of the most important changes are highlighted below.



The office of the district director has been eliminated and duties have been divided among several managing officials depending mainly on the subject matter. The Territory Manager, Insolvency Territory 7, now holds local IRS authority over bankruptcy matters for the Northern District of Illinois.



The old post office box (P.O. Box 745) for sending routine bankruptcy pleadings and correspondence to

the IRS has been eliminated. Documents and pleadings sent to that address may be returned to the sender as undeliverable.

As a result of the changes, the Associate Area Counsel, Small Business/Self-Employed, Chicago, has prepared the following instructions for practitioners and taxpayers who need to communicate with or to serve documents on the IRS in bankruptcy cases in the Northern District of Illinois. Please note that while these instructions apply to both the Eastern and Western Divisions of the bankruptcy court in the Northern District of Illinois, they do not apply to the bankruptcy courts in either the Central District of Illinois or the Southern District of Illinois. Nor do they apply to bankruptcy courts in any other district.

These instructions are effective immediately. If you have any questions, please contact Victoria S. Crosley, Associate Area Counsel, SB/SE, Chicago, at 312 886-9225, extension 345.

### **Serving the Internal Revenue Service** in Northern District of Illinois Bankruptcy Cases

#### **Adversary Proceedings and Contested Matters**

Bankruptcy pleadings in adversaries and contested matters before the United States Bankruptcy Court for the Northern District of Illinois (both Eastern and Western Division) should be served on the United States at both of the following addresses:

D. Patrick Mullarkey Tax Division (DOJ) P.O. Box 55

**United States Attorney** 219 South Dearborn Street Chicago, IL 60604

Ben Franklin Station Washington, DC 20044 FAX 202 514-5238

See Bankruptcy Rules 3007, 9014, 7004(b)(4); In re Richard J. Morrell, 69 B.R. 187, 87-1 U.S.T.C. ¶ 9142, 58 A.F.T.R. 2d ¶ 86-5345 (N.D. Cal. 1986).

A courtesy copy of the pleading may be sent to:

Mail Stop 5010 CHI 230 S. Dearborn Street Chicago, IL 60604

Internal Revenue Service Associate Area Counsel, SB/SE Internal Revenue Service Suite 2300 200 West Adams Street Chicago, IL 60606-5208 FAX 312 886-9244

Service on the U.S. Attorney and the Attorney General is only necessary for adversaries and contested matters. Note that the address above to D. Patrick Mullarkey, Tax Division (DOJ), constitutes service on the Attorney General for purposes herein described. Service additionally on the Attorney General at the Main Justice address is superfluous.

#### **Routine Pleadings**

The petition, schedules, monthly reports, and miscellaneous routine pleadings in cases in the United States Bankruptcy Court for the Northern District of Illinois (both Eastern and Western Division) should only be served on the Territory Manager, Insolvency Territory 7, at the following address (preferably omitting such official's name and title):

> Internal Revenue Service Mail Stop 5010 CHI 230 S. Dearborn Street Chicago, IL 60604

The territory manager is the local IRS official designated to receive service in bankruptcy cases, including notices under Bankruptcy Rules 2002(g) and 2002(j)(3), in lieu of

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#### Serving the Internal Revenue Service (continued from Page 19)

the district director (whose office was eliminated under the October 2000 IRS reorganization).

The post office box (745) formerly used by the IRS still appears in the service matrix in certain bankruptcy cases. It is no longer valid. Please substitute the foregoing address of the territory manager in any correspondence for which you would have used the old post office box number.

**Do not serve** routine pleadings and documents on the Attorney General, the U.S. Attorney, or IRS Counsel unless requested in a particular case. Note, however, that a cash collateral order may require service of certain routine pleadings not only on the territory manager but also on the IRS Counsel as specified in the order.

#### Additional information

The instructions in this memorandum apply only for cases before the United States Bankruptcy Court for the Northern District of Illinois (both Eastern and Western Division). Please use these addresses exactly as given without the name of any individual (except D. Patrick Mullarkey as specified above); use of names will slow down delivery, not expedite it. Do not serve the United States at other locations—pleadings sent elsewhere are merely forwarded to one of the above addresses; they are not read or processed at the inappropriate addresses.

Specifically, because case authority is delegated from the national offices to the field offices, *do not serve*:

Commissioner of Internal Revenue, Washington, DC Office of Chief Counsel, Washington, DC Area Counsel, Small Business/Self-Employed (SB/SE)

Once a taxpayer files a bankruptcy petition, the revenue officer transfers his/her responsibility to the Territory Manager, Insolvency Territory 7. Therefore, do *not serve*:

any revenue officer at any post of duty

Because the service centers are merely warehouses for returns except for a few processes not relevant to bank-ruptcy cases, *do not serve*:

Kansas City Service Center

#### **Contact Information**

If you have questions about any of the above, please call Victoria Crosley, Associate Area Counsel, Small Business/Self-Employed (SB/SE), at 312 886-9225, extension 345

If you have questions about specific docketed bankruptcy cases, start with a call to the office of the territory manager, Insolvency Territory 7. Cases are assigned to a par-

ticular insolvency group by the petitioner's name. For case names from A-K (and any case name beginning with a number rather than a letter), contact Insolvency Group 1 at 312 566-2875. For case names from L-Z, contact Insolvency Group 5 at 312 566-2827. It helps if you have the bankruptcy docket number and for very new cases, the taxpayer identification number (employer identification number or Social Security number).

We encourage you to attempt to resolve many of your concerns administratively prior to seeking recourse in the courts (which may then be avoided altogether). For example, when the service prepares a proof of claim and its records indicate an unfiled return, the claim will assert an estimated liability for that return. If the debtor later files the return in a different amount (or even claiming a refund), it is not necessary to object to the claim—merely furnish a signed copy of the late filed return to the case worker who will amend or withdraw the original claim.

For information on federal tax liens, probates, assignments for the benefit of creditors, and receiverships, lien subordination, release, or discharge of property from the lien, or offers in compromise, call 312 566-2855 to reach the Lien and Levy group; for information on non-bank-ruptcy collection activity call 312 566-2892 to reach the Technical Support Section Advisory Group formerly known as the Special Procedures Litigation unit.

Please note that I.R.C. § 6103 restricts the service from disclosing tax return information except under certain specified circumstances, so you may be asked for the taxpayer's consent or your power of attorney or equivalent.

#### IRS IIR Program continued from Page1

Additionally, one issue submitted to IRS, the timing of HMO provider holdback payment recognition, is still being considered for the IIR program.

A resolution team of IRS, Chief Counsel and Treasury personnel will be assembled for each issue. The teams will gather and analyze the relevant facts from industry groups and taxpayers for each issue and develop new guidance.

Notice 2002-20 provides more information on the IIR program and is available on the IRS Web site at *www.irs.gov*.

The issues selected are included in the IRS 2002 Priority Guidance Plan, which will also be available on the IRS Web site.

### **IDOR Amends Retailers' Occupation Tax Regulations**

The Illinois Department of Revenue (IDOR) has recently amended regulations under the Retailers' Occupation Tax Act to clarify existing rules by providing relevant examples. The department has also promulgated regulations to implement provisions of Public Acts and reflect certain case law.

The department promulgated rulemaking that amended 86 III. Adm. Code Section 130.310 Food, Drugs, Medicines, and Medical Appliances. The rulemaking included the addition of several examples of items that qualify for the low rate of sales tax afforded drugs and medicines.

To qualify for the low rate of tax as a medicine or drug, the product must contain a medicinal claim on the label. Recently many taxpayers and practitioners have sought guidance on what constitutes a medicinal claim. As a result, this rulemaking expressly added language to define a medicinal claim in Section 130.310(c)(1). The rulemaking further added 14 examples of language that qualify a product for the low tax rate when the language is listed on that product's label. The department also added nine examples of language that do not constitute medicinal claims and illustrative examples of terms that may or may not constitute a medicinal claim. The rulemaking also clarifies the tax treatment of a kit that includes both medicinal and non-medicinal items in Section 130.310(c)(2).

The Illinois Department of Revenue has amended its regulation on the rolling stock exemption, 86 Ill. Adm. Code 130.340, to clarify that lessors under leases of less than one year can claim the rolling stock exemption in the same manner as lessors under leases of one year or longer. This modification to Section 130.340(a) is to make the rolling stock rules consistent with the decision in AJF Warehouse Distributors, Inc. v. Department of Revenue, 265 Ill. App. 3d 1122 (1st Dist. 1994).

The changes to Section 130.340(a) also clarified that manufacturers who provide tangible personal property (such as shipping containers) to interstate carriers for hire for use as rolling stock may also claim the rolling stock exemption. The rulemaking also amended Section 130.340(e)(3) to explain that the provisions limiting the fair market value at time of reversion of the property also applies equally to owners, lessors, and shippers.

The amendment to Section 130.310 was published in the Illinois Register, 26 III. Reg. 9885, effective June 24, 2002. The amendment to Section 130.340 was adopted May 24, 2002, and published in the Illinois Register at 26 III. Reg. 8423.

# IRS Publication Has New Life Expectancy Tables for Figuring Retirement Distributions

The **Internal Revenue Service** (IRS) has put its new life expectancy tables into a separate publication.

Publication 590 SUPP, "Supplement to Publication 590, Individual Retirement Arrangements (IRAs)," is available through the IRS Web site at **www.irs.gov** and may be ordered by phone at **1 800 TAX-FORM (1 800 829-3676)**.

"This publication will be more convenient for taxpayers who want to use the new distribution rules this year," said IRS Commissioner Charles O. Rossotti.

The life expectancy tables were part of the final regulations on required distributions from retirement plans that were issued in April. They generally provide for smaller annual distributions, so participants may keep more funds in their tax-deferred plans.

For 2002, taxpayers have the option of using the new life expectancy tables or the tables in the existing Pub. 590.

The final regulations – T.D. 8987 – were published in Internal Revenue Bulletin 2002-19, which is also available through the IRS Web site.

### **Tax Workshops Scheduled**

The Internal Revenue Service (IRS) Small Business/Self-Employed Taxpayer Education and Communication office works with the Small Business Administration (SBA), the Small Business Development Centers (SBDC), Chambers, Accounting Firms, and the Chicago Community Venture to schedule workshops throughout Illinois for new small businesses. These workshops offer opportunities for new small business owners to ask questions and receive guidance in tax laws. Speakers may include representatives from the IRS, the Illinois Department of

Revenue (IDOR), the Social Security Administration (SSA), and the Illinois Department of Employment Security (IDES).

The following workshops and seminars have been scheduled through December 2002. For information on locations, times, and fees, have your clients call the contact for the workshop they would like to attend.

Workshop

| Date        | Workshop    | Location        | Contact                            |                        |
|-------------|-------------|-----------------|------------------------------------|------------------------|
| October —   |             |                 |                                    |                        |
| October 8   | Business    | Olney           | Illinois Eastern Community College | 618 395-3011           |
| October 8   | Payroll Tax | University Park | Governor's State                   | 708 534-4929           |
| October 17  | Business    | Chicago         | Chicago Community Venture          | 773 822-0310           |
| October 19  | Business    | Chicago         | Jane Adams Hull House              | 773 955-8027           |
| October 24  | Business    | River Grove     | Triton College                     | 708 456-0300 ext. 3246 |
| October 29  | Business    | Oglesby         | Illinois Valley Community College  | 815 224-0212           |
| October 30  | Business    | Kankakee        | Kankakee Community College         | 815 933-0376           |
| November    |             |                 |                                    |                        |
| November 4  | Business    | Decatur         | University of Illinois Extension   | 217 875-8284           |
| November 14 | Business    | Chicago         | Chicago Community Venture          | 773 822-0310           |
| November 14 | Business    | Ullin           | Shawnee Community College          | 618 634-3371           |
| November 14 | Business    | Palos Hills     | Morraine Valley Community College  | 708 874-5469           |
| November 19 | Business    | Edwardsville    | Southern Illinois University       | 618 650-2929           |
| November 21 | Business    | River Grove     | Triton College                     | 708 456-0300 ext. 3246 |
| December    |             |                 |                                    |                        |
| December 5  | Business    | River Grove     | Triton College                     | 708 456-0300 ext. 3246 |
| December 5  | Business    | Peoria          | Bradley University                 | 309 677-2852           |
| December 12 | Business    | Springfield     | Lincoln Land Community College     | 217 789-1017           |
|             |             |                 |                                    |                        |



#### IRS Issues Plain-Language Tax Guide for Churches and Religious Organizations

The **Internal Revenue Service** (IRS) has released a revised plain-language tax guide that explains the special tax laws and procedures that apply to churches and religious organizations.

Publication 1828, "Tax Guide for Churches and Religious Organizations," covers such topics as: avoiding activities that may jeopardize tax-exempt status; unrelated business income tax; recordkeeping requirements; and substantiation and disclosure rules that apply to charitable contributions. It replaces an earlier draft issued in 1994.

"Churches and religious organizations have a unique status in American society," said Steven T. Miller, director of the IRS's Exempt Organizations division. "Over the years, Congress has enacted special tax laws in recognition of that status. This publication explains these rules in a straightforward way to help these organizations understand and voluntarily comply with the tax rules."

The new publication reflects the tax laws enacted by Congress, Treasury regulations and court decisions. It uses examples to illustrate typical situations but is not intended to be comprehensive. "This quick reference guide is not intended to replace the law or to be the sole source of information on the tax law for churches and religious organizations," Miller said.

# Earn CPE Credits and Make a Difference

Established in 1969, **Internal Revenue Service** (IRS) Volunteer Income Tax Assistance (VITA) Program trains volunteers to prepare simple federal and state returns for low-income, elderly, people with disabilities and non-English speaking taxpayers at community locations. As a professional tax preparer, you could provide assistance to the VITA program in many ways, but IRS needs your expertise as a volunteer tax law instructor. Our volunteers need proper training to prepare accurate returns.

In addition to making a contribution to your community, you would be entitled to earn CPE credits while preparing for the class and while teaching. IRS provides the necessary training material and you would be invited to attend an instructor workshop.

In addition to tax law instructors, IRS needs professionals who can teach volunteers to use tax return preparation software. Once again, you would earn CPE credits while teaching as well as having the opportunity to attend a training session on the use of Tax Wise. This is a great learning opportunity, especially for those not yet involved in the electronic filing program. You could learn the entire *e-file* process while helping others.

Find out more about these opportunities to help people in your community and earn CPE credits by calling Rosie Robinson with the IRS in the Chicago area at 312 566-3337 or Sonya Jacobs at **217 527-6366** in Central and Southern Illinois.

### Treasury Web Site for IRS Real and Personal Property Sales

The U.S. Treasury World Wide Web site for **Internal Revenue Service** (IRS) real and personal property sales is located at **www.ustreas.gov/auction/irs**.

Sales of property that have been seized or acquired for nonpayment of internal revenue taxes are listed on this site. The **Internal Revenue Service** (IRS) no longer maintains a mailing list for future sales. Types of merchandise are categorized on the site so you can find the merchandise you are looking for easily. Questions regarding individual items for sale may be directed to the IRS representative in charge of the sale who is listed in the notice. Contact people are listed for each sale. Please read the legal notices covering the nature of title redemption rights, effect of junior encumbrances, title offered, and forms of payment before making your bid.



## for Practitioners

#### EROs Can E-file Until October 15, 2002

April 15th has come and gone, but for you, the ERO, it's still Tax Season.

Internal Revenue Service (IRS) e-file is still available until October 15th, 2002. Take advantage of the accuracy, security, and convenience of IRS e-file now! You can use IRS e-file for late, extended, or more complex tax returns. For more information about e-file, visit <a href="http://www.irs.gov">http://www.irs.gov</a>. If your clients pay estimated tax or other federal taxes separately from their tax return, inform them of the Electronic Federal Tax Payment System (EFTPS). For convenient and secure ways to make federal tax deposits, estimated tax, or delinquent tax payments, EFTPS can't be topped! Go to <a href="http://www.EFTPS.gov">http://www.EFTPS.gov</a> for more information. Remember, your last day to e-file is October 15, 2002!

#### IDOR District offices close in Park City, Peoria and Urbana

Effective June 28, 2002, the **Illinois Department of Revenue** (IDOR) permanently closed their doors to three district offices located in Park City, Peoria, and Urbana Illinois and one district office in Culver City, California. Recently, IDOR moved the district office in Marion to Carbondale. If you need tax assistance you can get help by calling **1 800 732-8866**, or visiting our Web site at **www.ILtax.com**.

Our nearest IDOR office to the Park City District Office is located at 9511 Harrison St, Des Plaines, Illinois 60016. Our nearest IDOR office to the Peoria and Urbana District Offices is located at 101 W. Jefferson Street, Springfield, Illinois 62794.

## IRS Provides Center Addresses to Tax Professionals

As the **Internal Revenue Service** (IRS) reassigns workloads at its processing centers, some taxpayers may be filing their tax returns at different locations from the previous year. Because many tax professionals will need the addresses to IRS centers before the tax filing season (January 1 – April 15), the IRS is providing them now to be used for tax year 2002 returns that will be filed during filing season 2003.

The IRS continues to redistribute workload among the 10 processing centers that process tax returns. Redistributing work among the centers is an example of the commitment of the IRS to provide better service to taxpayers.

For those who file paper returns, the new center addresses will be provided on the envelopes in the tax packages. For

these taxpayers, the IRS reallocation of workload to different centers will be seamless.

Taxpayers who e-file will not be affected by these changes for paper returns. More than a third of all individuals choose to e-file their federal tax returns.

If your client lives in Illinois, Indiana, Wisconsin, and you are filing a client's tax return and are not enclosing a payment, then file it at Internal Revenue Service, Kansas City, MO 64999-0002. If you are enclosing a payment, then file the return at Internal Revenue Service, P.O. Box 970011, St. Louis, MO 63197-0011.

#### New Smallwares Accounting Method Simplifies Recordkeeping And Allows Immediate Deduction

A new **Internal Revenue Service** (IRS) procedure allows restaurant and tavern owners to change accounting methods and expense the cost of replacement dishware, glassware and other items that previously had to be depreciated. The smallwares method of accounting allows restaurants and taverns to deduct the cost of these replacement items in the year purchased.

Generally smallwares consists of the following categories: glassware, flatware, dinnerware, pots and pans, table top items, bar supplies, food preparation utensils and tools, storage supplies, service items and small appliances costing \$500 or less.

The smallwares accounting method can only be used by persons engaged in the business of operating a restaurant or tavern that prepares food and beverages. It isn't available for new business start-up purchases of smallwares and does not apply to items purchased and stored at a warehouse or location other than the restaurant or tavern where the items are used.

Use Form 3115, Application for Change in Accounting Method to elect this method. You may download Form 3115 and the Revenue Procedure 2002-12, 2002-3, IRB 374 from the IRS Web site at *www.irs.gov*.

# Supplement to Pub. 590, Individual Retirement Arrangements

The **Internal Revenue Service** (IRS) has posted to *www.irs.gov* the June 2002 Supplement to Pub. 590 that contains the new Life Expectancy and Uniform Lifetime Tables for Figuring Required Minimum Distributions. *http://www.irs.gov/pub/irs-pdf/p590supp.pdf*.



## **IRS Official Rulings and Procedures**

## Weight Loss Treatments May Be Deductible

Rev. Rul. 2002-19, which appeared in Internal Revenue Bulletin 2002-16, dated April 22, 2002 provides that uncompensated amounts paid by individuals for participation in a weight-loss program as treatment for a specific disease or diseases (including obesity) diagnosed by a physician are expenses for medical cure under section 213 of the Code. The cost of producing diet food items is not deductible under section 213.

# New IRS Brochure Entitled "Home Based Business Tax Avoidance Schemes ... At a Glance"

Announcement 2002-48, which appeared in Internal Revenue Bulletin 2002-17, dated April 29, 2002 describes schemes that claim to offer tax "relief," but actually result in illegal tax avoidance. The promoters of these schemes claim that by setting up bogus home-based businesses, individual taxpayers can deduct most, or all of their personal expenses as business expenses.

#### Levy Procedures Concerning Installment Agreements

REG-104762-00, which appeared in Internal Revenue Bulletin 2002-18, dated May 6, 2002 outlines proposed regulations under section 6331 of the Code which provide for the prohibition of levy while an installment agreement is pending with the Secretary, while an installment agreement is in effect and following the rejection or termination of an installment agreement. The regulations clarify when levy is prohibited and the effect of the prohibition on the statute of limitations for collection. They also provide that the IRS may not commence a proceeding in court for the collection of tax included in a proposed or active installment agreement when levy is prohibited by this section.

## Industry Issue Resolution Program is Made Permanent

Notice 2002-20, which appeared in Internal Revenue Bulletin 2002-17, dated April 29, 2002 announces that the Industry Issue Resolution (IIR) Program, a pilot program aimed at resolving contentious tax issues involving business, is being made permanent and expanded to be available to all business taxpayers. Taxpayers, as well as industry associations and

other groups representing taxpayers are invited to suggest issues and possible options for resolution.

# Methods of Accounting; Inventories; Small Business Taxpayers

Rev. Proc. 2002-28, which appeared in Internal Revenue Bulletin 2002-18, dated May 6, 2002 outlines the procedure that provides that the Commissioner will exercise his discretion to accept qualifying small business taxpayers from the requirements to use an accrual method of accounting under section 446 of the Code and to account for inventories under section 471 of the Code.

# Minimum Distributions; Reporting Requirements

Notice 2002-27, which appeared in Internal Revenue Bulletin 2002-18, dated May 6, 2002 provides guidance on the reporting required from issuers, custodians and trustees with respect to required minimum distributions from Individual Retirement Accounts (IRAs).

## Methods of Accounting for Small Business Taxpayers

Announcement 2002-45, which appeared in Internal Revenue Bulletin 2002-18, dated May 6, 2002 discusses some of the most significant issues raised in comments received in response to Notice 2001-76 (2001-52 I.R.B. 613). The notice proposed procedures under which qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less would be exempted from the requirements to use an accrual method of accounting under section 446 of the Code and to account for inventories under section 471 of the Code for eligible businesses.

#### Transfers of Property Incident to a Divorce

Rev. Rul. 2002-22, which appeared in Internal Revenue Bulletin 2002-19, dated May 13, 2002 provides that a taxpayer who transfers interest in nonstatutory stock options and nonqualified deferred compensation to the taxpayer's former spouse incident to a divorce is not required to include an amount in gross income upon the transfer. Rather, the former spouse is required to include an amount in gross income when the former spouse exercises the stock options or when the deferred compensation is paid or made available to the former spouse.

(Continued on Page 26)



### **Rulings and Procedures – continued**

## **Employment Tax Issues on Property Transferred Incident to a Divorce**

Notice 2002-31, which appeared in Internal Revenue Bulletin 2002-19, dated May 13, 2002 provides the contents of a proposed revenue ruling concerning the employment taxation and reporting of nonqualified stock options and nonqualified deferred compensation transferred to a former spouse incident to a divorce.

#### **Minimum Distribution Rules**

REG-108697-02, which appeared in Internal Revenue Bulletin 2002-19, dated May 13, 2002 provides final, temporary and proposed regulations under section 401 of the Code related to minimum distributions from qualified plans, section 457 plans, section 403(b) annuity plans and retirement income accounts (IRAs).

#### **Lookback Period Ruling**

Ct.D. 2074, which appeared in Internal Revenue Bulletin 2002-20, dated May 20, 2002 explains that the Supreme Court has concluded that under sections 6501, 6322 and 6323 of the Code, the lookback period is tolled during the pendency of a prior bankruptcy petition. Young, et ux. V. United States.

#### **Electronic Filing Impediments Eliminated**

REG-107184-00, which appeared in Internal Revenue Bulletin 2002-20, dated May 20, 2002 provides the final, temporary and proposed regulations which are designed to eliminate regulatory impediments to the electronic filing of Form 1040, *U.S. Individual Income Tax Return*.

#### Cafeteria Plans

Rev. Rul. 2002-27, which appeared in Internal Revenue Bulletin 2002-20, dated May 20, 2002 provides that cafeteria plans may use an automatic enrollment process whereby the employee's salary is reduced each year to pay for a portion of the group health coverage under the plan unless the employee affirmatively elects cash. In addition, employers may treat all participants as being in the cafeteria plan for section 415 purposes even though the plan mandates salary reduction and coverage for uninsured participants.

#### Method of Accounting; Leased Vehicles

Rev. Proc. 2002-63, which appeared in Internal Revenue Bulletin 2002-21, dated May 28, 2002 outlines the procedures which provides taxpayers that purchase vehicles subject to leases and assume the associated leases from motor vehicle dealers with a safe harbor methods of accounting for capital cost reduction payments made by lessees, and a procedure for taxpayers to obtain automatic consent of the Commissioner to change the safe harbor method of accounting.

#### **Contingent Convertible Debt Instruments**

Rev. Rul. 2002-31, which appeared in Internal Revenue Bulletin 2002-22, dated June 3, 2002 provides guidance on the tax treatment of a debt instrument that is convertible into stock of the issuer and that also provides for one or more cash contingent payments.

# Automatic Approval for Change in Accounting Methods for Flow-Through Entities

Rev. Proc. 2002-38, which appeared in Internal Revenue Bulletin 2002-22, dated June 3, 2002 explains the procedures by which partnerships, S corporations, electing S corporations and personal service corporations may obtain automatic approval of the Commissioner to adopt, change or retain an annual accounting period under sections 441 and 442 of the Code.

# Payments to Employees for Equipment May Be Subject to Employment Taxes

Rev. Rul. 2002-35, which appeared in Internal Revenue Bulletin 2002-23, dated June 10, 2002 clarifies that payments to employees for equipment they are required to provide as a condition of employment are wages for federal employment tax purposes, unless paid under an accountable plan.

# Procedures for Electing Out of the Five Year Carryback Rule for Net Operating Losses

Rev. Proc. 2002-40, which appeared in the Internal Revenue Bulletin 2002-23, dated June 10, 2002 provides that certain taxpayers with net operating losses incurred in 2001 or 2002 must follow on or before October 31, 2002, for applying or electing out of the new five year carryback period enacted by the Job Creation and Worker Assistance Act of 2002.



### **Rulings and Procedures – continued**

## IRS to Streamline Technical Advice Memoranda Process

Rev. Proc. 2002-30, which appeared in Internal Revenue Bulletin 2002-24, dated June 17, 2002 provides for a pilot program that will test whether the process for issuing Technical Advice Memoranda (TAM) can be streamlined. The new advice will be known as Technical Expedited Advice Memoranda (TEAM).

#### **Rules Regarding Section 179 Deduction for Hybrid Vehicles**

Rev. Proc. 2002-42, which appeared in Internal Revenue Bulletin 2002-24, dated June 17, 2002 sets forth a process whereby taxpayers who purchase motor vehicles propelled by both a gasoline internal combustion engine and an electric motor that is recharged as the motor vehicles operate (hybrid vehicles) may rely on the original equipment manufacturer's (or in the case of a foreign original equipment manufacturer, its domestic distributor's) certification of the incremental costs of the motor vehicles' clean fuel property for purposes of Section 179A of the Code.

# New Publications Reflect Tax Law Changes

The IRS announces in Internal Revenue Bulletin 2002-26, dated July 01, 2002 that four new publications are available

which reflect changes in the law due to the Job Creation and Worker Assistance Act of 2002. The new publications are: Publication 3991, *Highlights of the Job Creation and Worker Assistance Act*; Supplement to Publication 463, *Travel, Entertainment, Gift, and Car Expenses*; Supplement to Publication 436, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*; and Supplement to Publication 946, *How to Depreciate Property*.

## Rules for Gross Proceeds Payments to Attorneys

REG-126024-01, which appeared in Internal Revenue Bulletin 2002-27, dated July 8, 2002 provides rules relating to the reporting of gross proceeds payments to attorneys. The regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. The regulations will affect attorneys who receive payments of gross proceeds on behalf of their clients and certain payors (for example, defendants in lawsuits and their insurance companies and agents) that, in the course of their trades or businesses, make payments to these attorneys.

#### **IRS Publishes List of Private Foundations**

Announcement 2002-64, which appeared in Internal Revenue Bulletin 2002-27, dated July 8, 2002, provides a list of organizations now classified as private foundations.

# IRS Provides Simplified Accountable Plan Rules for Certain Employers

Using the Industry Issue Resolution (IIR) program, the **Internal** Revenue Service (IRS) has issued guidance that provides employers in the pipeline construction industry an optional deemed substantiation method for reimbursing certain employee business expenses.

Under Revenue Procedure 2002-41, payments by pipeline construction employers to employees who are required to use their own welding or mechanics rigs as a condition of employment are deemed substantiated at up to \$13 an hour.

The IRS also issued Revenue Ruling 2002-35, which clarifies that payments to employees for equipment

they are required to provide as a condition of employment are wages for federal employment tax purposes, unless such amounts are paid under an accountable plan. The ruling also revokes Revenue Ruling 68-624. The new revenue procedure and revenue ruling do not apply to independent contractors.

Revenue Ruling 2002-35 and Revenue Procedure 2002-41 was published in IRB 2002-23, dated June 10.

RR2002-35: http://www.irs.gov/pub/irs-drop/rr-02-35.pdf

RP-2002-41: http://www.irs.gov/pub/irs-drop/rp-02-41.pdf.

Department of the Treasury Internal Revenue Service

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# Revised Federal-State Reference Guide Now Available

The newly revised Publication 963, "Federal-State Reference Guide," is now available on the **Internal Revenue Service** (IRS) Web site at *www.irs.gov/govts*.

Publication 963 is the primary reference guide for 90,000 state and local governments on tax and benefit issues concerning Social Security and Medicare coverage and the employment tax obligations of public employers. The publication was last revised in 1997.

"This revision of Publication 963 is the culmination of a partnership effort among the IRS, the Social Security Administration, and the National Conference of State Social Security Administrators," said Chuck Peterson, Director of the IRS's Government Entities Division. "It's an indispensable guide for state and local government entities."

The revised publication features expanded and updated explanations of public retirement systems, Social Security coverage rules and the reorganization

of the IRS and the Social Security Administration. It also includes updated contact information for individual assistance.

Public employers face tax-related requirements different from private or federal government employers. Most employees are covered either by mandatory Social Security and Medicare coverage or by voluntary "section 218 agreements." These are voluntary agreements, under section 218 of the Social Security Act, between the federal government and individual states to provide Social Security and Medicare coverage to public employees. Publication 963 addresses coverage for both situations, as well as the requirements for employees who are covered by non-Social Security retirement systems.

In addition to being on the IRS Web site, Publication 963 is available in print form and can be ordered by calling the IRS toll-free at 1 800 TAX-FORM (1 800 829-3676).